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IN THE SUPREME COURT OF THE UNITED STATES.

October Term, 1949.

No. .....

PHILLIPS PETROLEUM COMPANY, A CORPORATION,

Petitioner,

vs.

H. C. JONES, COLLECTOR OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Phillips Petroleum Company prays that a writ of certiorari issue to review the decision of the United States Court of Appeals for the Tenth Circuit entered in this case on August 2, 1949.

Opinion Below.

The opinion below is reported in 176 F. (2d) 737.

Jurisdiction.

Jurisdiction of this Court is invoked under Title 28, United States Code, Secs. 1254(1) and 2101(e).

The judgment and order of the Court of Appeals were entered on August 2, 1949 (R. 39, 46). Time for filing petition for rehearing was, on August 19, 1949, extended to September 15, 1949 (R. 46). Petition for rehearing was filed on

September 13, 1949, and was denied on October 12, 1949 (R. 47, 49).

Statute Involved.

The pertinent provisions of Sections 3480 and 3482 of the Internal Revenue Code (Title 28, U. S. C. A., Secs. 3480, 3482) are as follows:

> "Sec. 3480. *Imposition of Tax.* There shall be levied, collected, and paid, for and in respect of the several bonds and other documents, instruments, matters, and things mentioned and described in Sections 3481 and 3482, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, the several taxes specified in such sections."

> "Sec. 3482. *Conveyances.* Deed, instrument, or writing, (unless deposited in escrow before April 1, 1932), whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his, her, or their direction, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $100 and does not exceed $500, 55 cents; and for each additional $500 or fractional part thereof, 55 cents. This section shall not apply to any instrument or writing given to secure a debt."

The stamp tax on conveyances was originally enacted in 1917, reenacted in 1918, 1919, 1921 and 1924, remaining in force until repealed on March 23, 1926. It was re-enacted in 1932 and again in 1933, 1935, 1937, 1939, 1940 and 1941, at which time it was made a permanent tax. The language in all of these re-enactments was substantially identical (R. 33-35).

Summary Statement of the Matter Involved.

Petitioner brought this action to recover stamp taxes assessed by the Commissioner of Internal Revenue, purportedly under the provisions of Sections 3480 and 3482 of the Internal Revenue Code, and paid by petitioner to respondent with respect to oil and gas leases and assignments acquired by petitioner on lands located in Oklahoma and Kansas.

From October 26, 1920, until the stamp tax was repealed in 1926, and from 1932 until 1941, the Bureau had in force a regulation to the effect that what constitutes "lands, tenements or other realty" is "determinable by the law of the state in which the property is situated." Consonant with that regulation the Bureau ruled from time to time that oil and gas leases on lands in Oklahoma and Kansas were not subject to the tax, the Supreme Courts of those states having consistently ruled that oil and gas leases are personal property (R. 33-35).

By Regulations 71, in 1941, the Bureau omitted any definition of "lands, tenements or other realty" and there has not since been any Treasury regulation defining those words. On or about August 31, 1942, the Bureau of Internal Revenue published G. C. M. 23295 which stated that what constitutes "lands, tenements or other realty" is not controlled by state law but is to be determined under federal law. In that memorandum, general principles were laid down for determining what constitutes "lands, tenements or other realty" but it is not apparent therefrom whether an oil and gas lease is or is not deemed to be realty. The memorandum provided (R. 34):

> "State law creates legal interests but the Federal Statute determines when and how they shall be taxed.

Accordingly, reference will be made to State law to determine the character of the rights conveyed. Whether conveyances of such rights are taxable, however, is to be determined under Federal law. Published rulings not in accordance with the foregoing will no longer be followed.

• • • • • • • •

"For the purpose of determining liability for the stamp tax imposed by Section 3482 of the Internal Revenue Code, as amended, *supra,* the phrase 'lands, tenements or other realty' embraces those interests which endure for a period of time, the termination of which is not fixed or ascertained by a specific number of years, such as an estate in fee simple, life estate, perpetual easement, etc., and those interests enduring for a fixed period of years but which, either by reason of the length of the term or the grant of a right to extend the term by renewal or otherwise convey a bundle of rights approximating those of the class of interests first above mentioned. Thus, for example, a lease of real estate for 999 years, or a lease for 99 years renewable forever or for several succeeding terms is taxable. On the other hand, a lease for five years is not taxable even if the right is granted to renew it for several successive terms."

The District Court denied recovery (R. 36), and the Court of Appeals affirmed, although saying: *"It may be conceded that when judged by the laws of the States of Oklahoma and Kansas, or the general federal law, an oil and gas lease is not realty or an estate therein."* (R. 45)*

*All italics in quotations are supplied unless otherwise noted.

Questions Presented.

The ultimate question presented is:

Whether an "unless"** type of oil and gas lease on lands in Oklahoma and Kansas is an instrument in writing "whereby any lands, tenements or other realty sold" are granted, assigned, transferred, or otherwise conveyed, within the meaning of Sections 3480 and 3482 of the Revenue Code.

Subsidiary questions are:

1. Whether, as the Court of Appeals held, an oil and gas lease is "lands, tenements or other realty" within the meaning of the stamp tax statute, notwithstanding "It may be conceded that when judged by the laws of the states of Oklahoma and Kansas, or the general federal law, an oil and gas lease is not realty or an estate therein."

2. Whether the execution by a landowner of an oil and gas *lease* is a *sale* of lands, tenements or other realty; and whether, as the Court of Appeals held, the effect of the decision of this Court in *Burnet* v. *Harmel*, 287 U. S. 103, has been "greatly diminished if not wholly nullified" by *Anderson* v. *Helvering*, 310 U. S. 404.

3. Whether, in the absence of a definition in the statute, the words "lands, tenements or other realty" are to be

**These leases are for a term of (usually) ten years (called primary term) and as much longer as oil or gas is produced. They provide, however, that they shall terminate at the end of one year (usually) "unless" a well is commenced or rentals are paid for the privilege of delaying the commencement of a well for periods of one year (usually) (R. 10-16, 18-22). The leases are therefore leases from year to year, the commencement of a well or the payment of delay rentals being a condition precedent to the extension of the leases beyond the first year. Garfield Oil Co. v. Champlin, 78 Okl. 91, 189 Pac. 514. Not more than 1 per cent of the leases executed are extended beyond their primary terms. (R. 33)

construed by reference to the law of the state where the property is located or by the general federal law. (Oil and gas leases are admittedly personal property under both Oklahoma and Kansas law.)

(*a*) Whether *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, authorizes the avoidance of the "re-enactment" rule and the "contemporary construction" rule by the revocation of an administrative agency's *interpretative* regulation, or whether that decision is to be confined to the facts before the Court, *i. e., legislative* regulations.

4. Whether, in the event the statute is *not* to be construed by reference to state law, an oil and gas lease is "lands, tenements or other realty" under general federal law.

Reasons Relied Upon for Allowance of the Writ.

1. By reversing its regulation which had been in effect for 21 years (during which time the statute had been re-enacted 11 times without substantial change, thereby giving the regulation the force and effect of law) and assessing stamp taxes upon oil and gas leases on lands in Oklahoma and Kansas which had theretofore been ruled not subject to such taxes, the Commissioner of Internal Revenue has in effect levied a tax which Congress declined to levy, affecting many thousands of persons and corporations acquiring oil and gas leases, not only on lands in Oklahoma and Kansas, but in many other states. This presents an important question in the administration of the revenue laws warranting this Court's review. *Detroit Bank* v. *United States*, 317 U. S. 329.

2. A decision by this Court is necessary in order to authoritatively settle the question, not only for petitioner,

but for many thousands of persons and corporations who have acquired or who may acquire oil and gas leases on lands in Oklahoma and Kansas and many other states. (There are a number of suits pending in Oklahoma involving the same questions; there are many additional claims for refund filed with the Commissioner and many others to be filed; an *amici curiae* brief was filed in the Court of Appeals by counsel for nine oil companies.) *Moss* v. *Higgins,* 312 U. S. 940 (certiorari granted "because of the importance of the question and the number of pending cases in which it is presented").

3. The decision of the Court of Appeals that, "It may be conceded that when judged by the laws of the states of Oklahoma and Kansas, *or the general federal law,* an oil and gas lease is not realty or an estate therein" but that nevertheless such oil and gas leases are realty for the purposes of the federal stamp tax statute, is in conflict with the decisions of this Court in *Case* v. *Los Angeles Lumber Co.,* 308 U. S. 106; *McNelly* v. *Hill,* 293 U. S. 131; *Keck* v. *United States,* 172 U. S. 434, 446, holding that "where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary." *Case* v. *Los Angeles Lumber Co., supra.* The Court of Appeals has presumed to know "the will of Congress" outside of the meaning of the language used by Congress either in a legal sense or in a popular sense and without pointing to any fact or circumstance indicating that Congress did not intend what it said.

The Court of Appeals' reasoning leads to the conclusion that ordinary leases of farm or city property, no matter how short the term, are realty and subject to the tax—contrary to the construction of the Revenue Department, past and present (R. 34) and contrary to the universal law

of property. *Lycoming Fire Ins. Co.* v. *Haven,* 95 U. S. 210; 32 Am. Jur., p. 39; 19 Am. Jur., p. 519.

4. The decision of the Court of Appeals that the execution of an oil and gas lease is a "sale" of lands, tenements or other realty is in conflict with the holding of this Court in *Burnet* v. *Harmel,* 287 U. S. 103. The Court of Appeals erroneously held that the influence of the *Harmel* case "is greatly diminished, if not wholly nullified" by the decision of this Court in *Anderson* v. *Helvering,* 310 U. S. 404, 408, to the effect that the outright sale of an oil and gas lease by the lessee constitutes a conversion of capital assets. The court failed to distinguish between the *execution* of an oil and gas lease *by the landowner* and the *assignment* of an oil and gas lease *by the lessee.* There is no conflict between the decision of this Court in the *Harmel* case and in the *Anderson* case.

5. In holding that state law does not govern the determination of what constitutes "lands, tenements or other realty," the Court of Appeals refused to recognize that the repeated re-enactment of the statute in the face of the Bureau's regulation gave the regulation the force and effect of law. The decision conflicts with the holdings of this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.,* 206 U. S. 110; *United States* v. *Hermanos Y. Compania,* 209 U. S. 339; and *United States* v. *Zazove,* 334 U. S. 602. The Court of Appeals held that in view of the change in the regulation prior to the assessment of the tax, it was bound by the decision of this Court in *Helvering* v. *Wilshire Oil Co.,* 308 U. S. 90, not to give effect to the re-enactment rule. The Court of Appeals erred in failing to distinguish that case on the ground that it involved a *legislative* regulation whereas this case involves an *interpretative* regulation, and failed to

recognize that the language of that case should be interpreted in the light of the facts before the court. *Armour & Co.* v. *Wantock,* 323 U. S. 126, 132. It is highly important that this Court authoritatively determine whether or not the "re-enactment" rule has been abrogated by this Court's decision in the *Wilshire* case.

(*a*) The statute is susceptible to the construction that state law governs in determining what constitutes "lands, tenements or other realty." *Poe* v. *Seaborn,* 282 U. S. 101; *United States* v. *Cambridge Loan & Bldg. Co.,* 278 U. S. 55.

6. The Court of Appeals erred in failing to give effect to the long-continued construction of the Act by the Bureau of Internal Revenue to the effect that state law governs in the determination of what constitutes "lands, tenements and other realty" regardless of the applicability of the re-enactment rule. The decision conflicts with *White* v. *Winchester Country Club,* 315 U. S. 32, and many other decisions of this Court. See annotations in 73 L. ed. 322-375, and 84 L. ed. 28-76. It is highly important that this Court authoritatively determine whether or not the "contemporary construction" rule has been abrogated by this Court's decision in the *Wilshire* case.

Wherefore, it is respectfully submitted that this petition should be granted.

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BRIEF IN SUPPORT OF PETITION FOR *CERTIORARI.*

I.

Opinion of the Court Below.

The opinion of the Court of Appeals for the Tenth Circuit is reported in 176 F. (2d) 737.

II.

Jurisdiction.

The basis upon which the jurisdiction of this Court is invoked is stated in the petition, p. 1.

III.

Statement of the Case.

It is believed that a sufficient statement of the case has been made in the preceding petition (pp. 3-4) under the heading "Summary Statement of the Matter Involved," which in the interest of brevity is adopted here.

IV.

Specification of Errors.

1. The Court of Appeals erred in holding that the tax was properly assessed in the face of its concession that when judged by state or general federal law oil and gas leases are not "lands, tenements or other realty."

2. The Court of Appeals erred in holding that the execution of an oil and gas lease by the landowner is a "sale" of lands, tenements or other realty.

3. The Court of Appeals erred in holding that the character of oil and gas leases as being conveyances of "lands, tenements or other realty" is not governed by the law of the state in which the land is located.

(*a*) The Court of Appeals erred in failing to hold that the statute was susceptible to construction, and that the

long-continued construction of the act by the Commissioner of Internal Revenue to the effect that state law governs in the determination of the character of the leases, plus the re-enactment of the statute in substantially identical terms eleven times while the regulation was in effect, gave the regulation the force and effect of law. The Court erroneously held that because of the change in the regulation by the Commissioner of Internal Revenue prior to the assessment of the tax, the Court was bound by the decision of this Court in *Helvering* v. *Wilshire Oil Company,* 308 U. S. 90, not to give effect to the re-enactment rule. The Court should have distinguished that case on the ground that it involved a legislative regulation whereas this case involves an *interpretative* regulation.

ARGUMENT.

Point I.

The Court of Appeals erroneously held that the taxes were properly assessed in the face of its concession that an oil and gas lease is not "lands, tenements or other realty" when judged by state or general federal law.

In the penultimate paragraph of the opinion, the Court of Appeals says:

> "It may be conceded that when judged by the laws of the states of Oklahoma and Kansas, or the general federal law, an oil and gas lease is not realty or an estate therein.[1] But even so, we are concerned only with the meaning and application of a federal excise tax, imposed by Congress in the exercise of its plenary power

1. The Court probably used the term "estate" in realty in its common law technical sense rather than its popular sense. See 1 Tiffany on Real Property (Perm. Ed.), Sec. 3, p. 7, and Appendix A, p. 33.

under the Constitution. It is the will of Congress which controls and in the absence of express[2] language to the contrary, the Act is to be interpreted to give uniform application to a nation-wide scheme of taxation."

It is submitted that the requirement that the Act be interpreted to give uniform application to a nation-wide scheme of taxation is satisfied by a decision that oil and gas leases in all states are *not* subject to the tax, as well as that they are. That statement therefore affords no basis for the Court's holding that neither state nor general federal law governs. If federal law governs, then the tax will be either applicable or not applicable to oil and gas leases on lands in every state in the Union.

It is submitted that the concession that oil and gas leases are not realty when measured by state law or the "general federal law" requires a conclusion that Congress did not intend to tax them.

We think there is no difference in the commonly understood or popular meaning (see Webster's New International Dictionary, Second Edition) and the legal meaning of the words "lands, tenements or other realty," but we need not discuss that point, because, even if there is a difference, the legal meaning governs. 50 Am. Jur., pp. 265, 266. Moreover, in so far as we can interpret the Court's opinion, the decision is not predicated upon the commonly understood or popular meaning of the words, nor upon their legal meaning.[3]

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2. This Court says "or by necessary implication." Burnet v. Harmel, 287 U. S. 103.

3. The opinion appears to proceed upon the theory that because the Oklahoma Supreme Court has held an oil and gas lease to be "an *interest* in land," "an *interest* in real estate," "an *interest* in real property," an instrument "*relating* to real estate" within the meaning of various Oklahoma statutes, it is not "a perversion of its true char-

The legal meaning of the words used controls:

It cannot be doubted that the words "lands, tenements or other realty" have a fixed meaning in law (1 Tiffany on Real Property (Perm. Ed.), Secs. 3 and 10; Restatement of the Law of Property, Sec. 8; *Harrell* v. *Miller,* 35 Miss. 700, 72 Am. Dec. 154, 156; the Court of Appeals has conceded as much). Therefore those words are to be interpreted in accordance with that meaning. 50 Am. Jur., pp. 265, 266.

In *Case* v. *Los Angeles Lumber Co.,* 308 U. S. 106, 84 L. ed. 110, Mr. Justice DOUGLAS, speaking for the court, said:

> "The words 'fair and equitable' as used in Sec. 77B(f) are words of art which prior to the advent of Sec. 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations. Hence, as in case of other terms or phrases used in that section, *Duparquet Huot & M. Co.* v. *Evans,* 297 U. S. 216, 80 L. ed. 591, 56 S. Ct. 412, 30 Am. Bankr. Rep. (NS) 329, we adhere to the familiar rule that where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary. *Keck* v. *United States,* 172 U. S. 434, 446, 43 L. ed. 505, 510, 19 S. Ct. 254."

In *McNally* v. *Hill,* 293 U. S. 131, 136, 79 L. ed. 238, 241, the court said:

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acter to say that it is realty for documentary stamp purposes." Having already held that state law does not govern, it is not clear why the Oklahoma holdings were cited.

In the appendix to this brief, we are quoting each statement of the Court of Appeals with respect to the holdings of the Oklahoma Court, and we are demonstrating that the same holding has been made, or must necessarily be made under the clear language of the applicable statutes, *with respect to ordinary farm or urban leases,* particularly when made for a term in excess of one year. Thus the reasoning of the Court of Appeals leads to the conclusion that all leases of land are realty and are subject to the stamp tax—a result which the Commissioner's own regulations refute, and a result contrary to the universal law of property (see Appendix A).

"The statute does not define the term habeas corpus. To ascertain its meaning and the appropriate use of the writ in the federal courts, recourse must be had to the common law, from which the term was drawn, and to the decisions of this court interpreting and applying the common law principles which define its use when authorized by the statute." (Citing authorities.)

In *Keck* v. *United States,* 172 U. S. 434, 446, the court said:

"These conclusions arising from a consideration of the text of the statute are rendered yet clearer by taking into view the definite legal meaning of the word 'smuggling.' That term had a well-understood import at common law, and, in the absence of a particularized definition of its significance in the statute creating it, resort may be had to the common law for the purpose of arriving at the meaning of the word. *Swearingen* v. *United States,* 161 U. S. 446, 451, 16 S. Ct. 562 [40 L. ed. 765]; *United States* v. *Wong Kim Ark.,* 169 U. S. 649, 18 S. Ct. 456 [42 L. ed. 890]."

The Court of Appeals for the Tenth Circuit has recognized this rule on other occasions. Thus, in an opinion by Judge MURRAH in *Leyerly* v. *United States,* (C. C. A. 10) 162 F. (2d) 79, 85, the court said:

"The statute does not define the term *loco parentis* and the common law concept therefore controls."

Again, in *Sinclair Refining Co.* v. *Burroughs,* (C. C. A. 10), 133 F. (2d) 536, 539, the court said:

"The applicable statute having directed that the assessment shall be levied on the land benefited by the improvement, it follows that the interests of the pipe line companies can be assessed only if they fall within the term 'land' as it has been defined by law."

See also, *Westerlund* v. *Black Bear Mining Co.,* (C. C. A. 8,

per SANBORN, J.) 203 Fed. 599, 608; *Hoffman* v. *Palmer,* (C. C. A. 2) 129 F. (2d) 976, 983.

In the light of these established principles, how could the Court of Appeals reach the conclusion that an oil and gas lease is realty for the purpose of the stamp tax when it is not realty in the eyes of the law? What indication is there in this statute that Congress intended these words to have any meaning other than their legal meaning? Certainly no such indication may be found from the purpose of the statute. The purpose was to tax—but not to tax everything. The purpose was to tax conveyances of a specified character. No purpose can be imputed to tax all instruments relating to realty. A purpose to avoid such an effect is evident from the wording of the statute. The Commissioner does not construe it that way, even now. So by what right did the Court add to the statute so as to include instruments not embraced by its language?

We are at a loss to know what the Court of Appeals meant by its statement that "its [realty?] technical definition belongs to antiquity, but it takes its color and content from modern business practices." Was that intended to say that "realty" is no longer realty? That it has grown to mean something else? That the meaning has broadened to the extent of including instruments *relating* to realty such as an oil and gas lease or a lease of a farm or dwelling? If so, where is the proof? The dictionaries, the text writers and the court decisions refute any such idea.

However, we do not understand the Court to say that the legal meaning of the words under consideration has changed by development of the common law in this country to the extent of embracing an oil and gas lease. The statement of the court that "It may be conceded that when

judged by the laws of the states of Oklahoma and Kansas, or the general federal law, an oil and gas lease is not realty or an estate therein" belies any such idea. The "general federal law" is the common law of the United States as it exists today with such modernizations as the courts may have given it. *Funk* v. *United States,* 290 U. S. 371, 78 L. ed. 369; *Barnes Coal Corp.* v. *Retail Coal Merchants Ass'n,* (C. C. A. 4) 128 F. (2d) 645, 648.

It was that modernized common law which we presented in our brief in the Court of Appeals in support of our contention that an oil and gas lease is not realty under federal law, and which the Court conceded.

Contrary to the indications of the opinion in this case, the decision is not supported by the decision of the District Court of Maryland in *Jones* v. *Magruder,* 42 F. Supp. 193. The court there considered a 99-year lease, renewable forever, supplemented by a Maryland statute authorizing the lessee to convert the lease into a fee. The court said:

> "Probably in no state of the United States other than Maryland would a deed for a leasehold estate for 99 years renewable forever not be considered a conveyance of land or realty at this time."

That was a finding that under federal common law such a lease is realty. No such finding has been or can be made in the case at bar. The Court concedes the contrary.

It is submitted therefore that the decision in this case is in conflict with the decisions of this Court, as well as with previous decisions of the Court of Appeals for the Tenth Circuit and other circuits, and the Court of Appeals should have held that the oil and gas leases were not subject to the stamp tax.

The Court of Appeals correctly conceded that under general federal law an oil and gas lease is not "lands, tenements or other realty":

It is with some hesitancy that we discuss this point. It would seem that if the Court of Appeals' decision is wrong on the basis of its concession, the writ ought to issue, but we have concluded to support the validity of that concession so that the Court can consider the point if it is so advised. Inasmuch as we believe the point is irrelevant to the issues raised by the application for the writ, we are relegating the discussion of that point to the appendix (see Appendix B).

Point II.

The execution of an oil and gas lease by a landowner does not constitute a "sale" within the meaning of Sections 3480 and 3482 of the Revenue Act.

It will be observed that the tax is levied upon the instrument whereby "lands, tenements or other realty *sold*" is granted, etc. There must have been a sale. If there has not been a sale, whatever document reflects the transaction is not subject to the tax.

What has been sold when an oil and gas lease is executed? All that the lessee has is an option to go upon the property and explore it for oil and gas and, if any is found, to reduce it to possession, at which time he obtains title to the oil and gas and not before. When he obtains title the oil and gas are personal property and not realty. *Burden* v. *Gypsy Oil Co.*, 141 Kan. 147, 40 P. (2d) 463; *Keystone Pipe & Supply Co.* v. *Crabtree*, 174 Okl. 562, 50 P. (2d) 1086, 1088.

This Court, as well as several Courts of Appeals, has

held that the execution of an oil and gas lease *does not constitute the sale of anything.*

In *Burnet, Commissioner,* v. *Harmel,* 287 U. S. 103, the court had for consideration the question of whether or not the bonus received by a landowner for the execution of an oil and gas lease is taxable as a capital gain under the provisions of Section 208(a)(1) of the Revenue Act of 1924, which provided:

> "The term 'capital gain' means taxable gain from the *sale* or exchange of capital assets consummated after December 31, 1921."

The court held that an oil and gas lease on lands in Texas was not a sale of a capital asset within the meaning of the above statute, notwithstanding that under the law of Texas (contrary to the rule in most states) an oil and gas lease passes title to the lessee to the oil and gas in place. This case goes much farther than we need go here in order to sustain our position, bcause under the capital gains statute it need not be shown that there was a sale of any *realty;* it is sufficient if there is a sale of *realty or personalty* which constitutes a capital asset. But this Court held that *there was a sale of nothing.* After stating that the execution of an oil and gas lease and the receipt of a bonus or royalties thereon was not the type of hardship which the capital gains statute was designed to correct, the court said:

> "Moreover, the statute speaks of a 'sale' and these leases would not generally be described as a 'sale' of the mineral content of the soil, using the term either in its technical sense or as it is commonly understood. Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas. By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil

and gas for a prescribed period; he may explore, drill and produce oil and gas, if found. Such operations with respect to a mine have been said to resemble a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident, *rather than a sale of the land or of any interest in it or in its mineral content. Stratton's Independence* v. *Howbert,* 231 U. S. 399, 414, 415, 58 L. ed. 285, 291, 292, 34 S. Ct. 136; see *Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503, 521, 61 L. ed. 460, 470, 37 S. Ct. 201."

On pages 14-16 of the brief filed by him in the Supreme Court of the United States in that case, the Commissioner of Internal Revenue had the following to say on this point:

"When the capital gains provisions first appeared in the Revenue Act of 1921 (c. 136, 42 Stat. 227) it was then regarded as settled law that mining leases did not convey title to the ore in place. See *Lynch* v. *Alworth-Stevens Co.,* 267 U. S. 364, 371, and *Ewert* v. *Robinson,* 289 Fed. 740, 747 (C. C. A. 8th).

• • • • • • • •

"The section of the statute here involved does not indicate any intent to depart from this well-established rule. On the contrary, applying well settled principles of construction, Congress is presumed to have legislated with the settled principles applicable to mineral leases in mind (*United States* v. *Merriam,* 263 U. S. 179, 187), and must be presumed to have used the term 'sale' in its usual, ordinary and every-day meaning (*Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552, 561). It is not to be presumed that Congress used the word in a sense not applicable to oil and mining leases under established law and usage recognized and declared by the decisions of the courts. Since a lease like the one involved in the case at bar was understood at the time of the enactment of the law as a lease and not as a conveyance, Congress could not have intended that such a lease

should be comprehended within the meaning of the term 'sale'."

The language used in the Commissioner's brief, quoted above, is equally applicable to the case at bar. The only distinction is one of tense—the word "sale" in the present tense and the word "sold" in the past tense—scarcely a basis for reaching a contrary conclusion.

See also *United States* v. *Seattle-First National Bank,* 321 U. S. 583; *Burkett* v. *Commissioner of Internal Revenue,* (C. C. A. 8) 31 F. (2d) 667 (cert den. 280 U. S. 565); *Alexander* v. *King,* (C. C. A. 10) 46 F. (2d) 235, 74 A. L. R. 174 (cert. den. 283 U. S. 845).

In *Burkett* v. *Commissioner, supra,* the Eighth Circuit Court said:

> "Whether this instrument can be described by any defined legal terms—such as lease, license, etc.—it is certain that it is only a limited grant of a right in respect to land and for a limited period of time by one having the fee and possession. *Such cannot be denominated a sale in the ordinary sense of that word, and there is no reason to construe Section 206 as using 'sale' in any other sense.* The wording and the legislative history of Section 206 are clear that it was intended to apply to 'sales' in the sense of *conveyance of title to property, not of the creation of privileges or estates or rights in property for a limited period of time.*" (Italics by the court.)

In *Alexander* v. *King, supra,* the Tenth Circuit Court of Appeals said:

> "Plaintiffs argue that, by the making of a lease, they in effect sold their right to explore for a consideration payable in installments, just as much as one who sells his royalty interest for a present consideration.

But the difference is that between an outright sale and a lease for a term. A landowner has the incorporeal right to search for and take described in the authorities cited. He can exercise that right in person, or through another on such terms as are agreeable to him and his lessee. But in either event he has parted forever with it. Royalty is compensation for an exercise of the right. *Again, the difference is between the sale of a farm, and a contract transferring the right to use it for a term.*"

The Court of Appeals has decided this issue by saying:

"But the influence of the *Harmel* and *King* cases is greatly diminished, if not wholly nullified, when it is considered that regardless of local characterizations, the outright sale of an oil and gas lease, when held for the statutory period, constitutes a conversion of capital assets. See *Anderson* v. *Helvering,* 310 U. S. 404, 408; *McLean* v. *Commissioner,* 120 F. (2d) 942; *Commissioner* v. *Fleming,* 82 F. (2d) 324; *Anderson* v. *Commissioner,* 81 F. (2d) 457; Mertens Law of Income Tax, Sections 22.24, 24.24, 24.25 and 24.26."

Apparently the Court of Appeals failed to appreciate that this phase of our argument was directed at the leases executed directly by the landowner to petitioner as lessee and not at the leases acquired by petitioner by assignment from other lessees. Of course the *assignment* of a lease by the lessee for a consideration is the sale of a capital asset, but we are at a complete loss to understand how the decision of this Court to that effect in *Anderson* v. *Helvering,* 310 U. S. 404, "greatly diminished, if not wholly nullified" the decision of this Court in *Burnet* v. *Harmel, supra,* to the effect that the *execution of an oil and gas lease by the landowner is not the sale of anything.*

It is submitted that the decision of the Court of Appeals on this issue is in conflict with this Court's decision

in *Burnet* v. *Harmel, supra,* and with the Eighth Circuit's decision in *Burkett* v. *Commissioner, supra,* and with the Tenth Circuit's own decision in *Alexander* v. *King, supra,* and that the decision of this Court in *Anderson* v. *Commissioner, supra,* did not authorize the Court of Appeals to depart from the rule established by those decisions.

Point III.

The stamp tax statute is properly construed by reference to state law.

The Court of Appeals conceded that under Oklahoma and Kansas law, an oil and gas lease is not realty (R. 45). See *State* v. *Shamblin,* 185 Okl. 126, 90 P. (2d) 1053, 1055, and cases there cited; *Connell* v. *Kanwa Oil Co.,* 161 Kan. 649, 170 P. (2d) 631, 634, and cases there cited.

But the court held that the stamp tax statute should not be construed by reference to state law. The decision seems to have been superfluous in view of the further holding that in ascertaining the "will of Congress" the court will not be guided by the meaning of the language used under either state or general federal law! We have undertaken to show, under Point I, that the court was in error in that respect. We now shall undertake to show that the court was also in error in holding that resort should not be had to state law for determining whether an instrument is a conveyance of "lands, tenements or other realty."

The statute is susceptible to the construction that the nature of the rights conveyed by an instrument should be determined by the law of the state where the land is located. Resort has been had to local law under similar statutes. *Poe* v. *Seaborn,* 282 U. S. 101; *United States* v. *Cambridge Loan & Bldg. Co.,* 278 U. S. 55; *Crooks* v. *Harrelson,* 282 U. S. 55; *United States* v. *Robbins,* 269 U. S. 315; *Tyler* v.

United States, 281 U. S. 497; *Blair* v. *Commissioner*, 300 U. S. 5.

The identical statute has been interpreted by reference to local law by the Court of Appeals for the Ninth Circuit. *Milwaukee Land Co.* v. *Poe*, 31 F. (2d) 733.

In its brief in *Morrow* v. *Scofield*, (C. C. A. 5) 116 F. (2d) 17, the Government took the position we are now taking. In distinguishing this statute from the capital gains statute involved in *Burnet* v. *Harmel, supra*, the Government there said:

> "As acknowledged in that opinion, Congress has set up its own criteria of what is income and what are capital gains in its definitions of those terms found in the revenue act, and those criteria cannot be disturbed by state law. *In the instant case, however, Congress has not set up its own criteria. It has not defined what it means by a transfer of 'lands, tenements or other realty,' and there is no place to look for such a definition but to the state law. It is commonly understood that resort must always be had to the local law to ascertain whether rights or interests created thereunder are within the intended scope of the taxing act. Freuler* v. *Helvering*, 291 U. S. 35; *Poe* v. *Seaborn*, 282 U. S. 101. Dependence upon the state law is expressly recognized in the *Harmel* decision wherein the court stated (p. 110):
>
> > 'The state law creates legal interests but the federal statute determines when and how they shall be taxed.'
>
> *"It is not accurate to say, as taxpayer does, that the difference between the state laws in respect to the effect of oil and gas leases is merely a matter of names. The disparity springs from a different concept of ownership. The reason that states other than Texas hold that oil and gas leases, like the ones in question, do not convey title to the oil and gas in the ground is be-*

cause in those states the courts do not conceive that the owner of property has absolute title to the oil and gas beneath the surface. Kolachny v. *Galbreath*, 26 Okl. 772, 110 Pac. 902; *Watford Oil & Gas Co.* v. *Shipman*, 230 Ill. 536, 82 N. E. 888; *Ohio Oil Co.* v. *Indiana*, 177 U. S. 190."

It scarcely can be controverted that the statute is *susceptible* to the construction we are advocating, if, indeed, such construction is not *required*.

That being true, the long-continued construction by the Commissioner in the manner advocated by us, plus the re-enactment of the statute by Congress in the face of the Commissioner's regulation gave the regulation the force of law. *Helvering* v. *Winmill*, 305 U. S. 79; *Helvering* v. *R. J. Reynolds Tobacco Co.*, 206 U. S. 110; *United States* v. *Hermanos Y. Compania*, 209 U. S. 339; *United States* v. *Zazove*, 334 U. S. 602; *United States* v. *Seattle-First National Bank*, 321 U. S. 583.

Aside from the re-enactment of the statute, the long-continued construction of the Act by the Commissioner is entitled to great weight in determining its meaning. *White* v. *Winchester Country Club*, 315 U. S. 32, and see annotations in 73 L. ed. 322-375 and 84 L. ed. 28-76.

Undoubtedly these principles would require a holding that this case is governed by the law of Oklahoma and Kansas but for the rescission of the Commissioner's regulation after it had been in effect for approximately 21 years. Because of that rescission, the Court of Appeals held that under the holding of this Court in *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, the re-enactment rule did not apply.

That case dealt with a *legislative* regulation (see "Treasury Regulations and the Wilshire Case," Vol. XL of Columbia Law Review, No. 2, p. 252), and notwithstand-

ing the fact that the court's language may be broad enough to include *interpretative* regulations, the holding should be confined to the facts before the court. *Cohens* v. *Virginia*, 6 Wheat. 264; *Armour & Co.* v. *Wantock*, 323 U. S. 126, 132.

Not only is this the well established rule, from which there is no dissent, but it must be apparent that this Court did not intend to nullify the well established rule that the re-enactment of an ambiguous statute in the face of a regulation by the administrative agency charged with the enforcement of the statute gives added weight, if it does not make conclusive, the validity of the construction of the Act by the administrative agency. Subsequent decisions by this Court negative any idea that an administrative agency by the mere expedient of changing its regulation can obviate the effect of its long-continued construction of an *ambiguous* statute, with added force resulting from re-enactment of the statute by Congress. Thus in *United States* v. *Zazove*, June 14, 1948, 334 U. S. 602, 92 L. ed. 1601, Chief Justice VINSON, speaking for the Court, said:

> "Accordingly when Congress enacted the 1946 bill, it in effect incorporated the old provisions of Section 602(h)(2), which was the basis for Regulation 3450 and in our view thereby *accepted the construction* embodied in that regulation, which had been so clearly brought to attention on this and prior occasions."

If Congress "accepted" the construction of the statute embodied in a regulation, that can mean nothing less than that Congress intended the statute to mean the same thing. That being true, it is inconceivable that the congressional intent thus evidenced could be nullified by the subsequent revocation or change of the administrative regulation. No doubt Chief Justice VINSON by the language above quoted meant precisely what this Court said in *United States* v. *Hermanos Y. Compania*, 209 U. S. 339:

> "And we have decided that re-enactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an *adoption* by Congress of such construction. *United States* v. *Falk,* 204 U. S. 143, 152."

If Congress adopted that construction, how could an administrative agency possibly change that construction by revoking or altering the regulation existing prior to the re-enactment of the statute?

Again in *Crane* v. *Commissioner,* 331 U. S. 1, 7, 91 L. ed. 1301, 1306, (April, 1947) Chief Justice VINSON, speaking for the Court, said with respect to an interpretative regulation of the Commisisoner of Internal Revenue concerning the meaning of a tax statute:

> "As the quoted provision of the Regulations has been in effect since 1918, and as the relevant statutory provision has been repeatedly reenacted since then in substantially the same form, the former may itself now be considered *to have the force of law.*"

Clearly, therefore, the Court of Appeals was in error in applying the rule of the *Wilshire* case to an interpretative regulation. In any event, the writ should be granted in order to clarify the application of the rule of the *Wilshire* case.

Conclusion.

For the reasons stated above, the petition for a writ of *certiorari* should be granted and the decision of the Court of Appeals should be reversed.

Respectfully submitted,

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APPENDIX A.

Applicability of Court of Appeals' Reasoning to Ordinary Farm or Urban Leases.

The Court of Appeals said:	*Comparable Situation With Respect to Ordinary Farm or Urban Lease.*
"While clinging to the technical common law definitions, the Oklahoma courts have nevertheless held:	
(*1*) "that an oil and gas lease is within the statute of frauds applicable to real estate;	(*1*) The same as to all leases for a longer period than one year. Title 15, Sec. 136, O. S. A.; *Nat'l Bank of Hastings* v. *Pierce*, 94 Okl. 153, 221 Pac. 111.
(*2*) "its conveyance by a corporation is required to be attested by its secretary in accordance with a statute relating to real estate;	(*2*) The same. Title 16, Sec. 94, O. S. A., provides: "Every deed *or other instrument affecting real estate* executed by a corporation • • • must be attested by the secretary • • •."
(*3*) "it is a conveyance within the homestead laws of the state;	(*3*) The same as to leases for a longer period than one year. Title 16, Sec. 4, O. S. A., provides: "• • • no deed, mortgage *or contract relating to* the homestead exempt by law, *except a lease for a period not exceeding one year*, shall be valid unless in writing and subscribed by both husband and wife • • •." *Kelly* v. *Mosby*, 34 Okl. 218, 124 Pac. 984.

(4) "and it is a grant of real property* within the meaning of the Oklahoma statute relating to breaches of covenants in a grant of an estate of real property.

(4) The same. Title 23, Sec. 25, O. S. A., provides: "The detriment caused by the breach of a covenant of seisin, of right to convey, of warranty, or of quiet enjoyment, in a grant of an *estate* in real property, is deemed to be: * * *." We find no decisions applying the statute to ordinary leases, but the language of *Nicholson Corp.* v. *Ferguson,* 114 Okl. 10, 243 Pac. 195, cited for the Court's statement, applies, as well, to ordinary leases.

(5) "It has been held that an exception in a deed of conveyance reserving unto the grantor the oil and gas, is a reservation of an interest in land;

(5) This relates to the lessor's interest after the execution of an oil and gas lease and sheds no light upon the nature of an oil and gas *lease.* But, it is clear that the *lessor's* interest after executing an ordinary lease is *at least* an *interest* in land.—It is the fee.

(6) "it is a proper subject of an equitable proceedings to quiet title;

(6) The same. Title 12, Sec. 1141, provides: "An action may be brought *by any*

*All of the quoted statements were taken verbatim from Continental Supply Co. v. Marshall, 152 F. (2d) 300, 306, and for this statement the Court cites Nicholson Corp. v. Ferguson, 114 Okl. 10, 243 Pac. 195. The Oklahoma court did not hold that an oil and gas lease was a "grant of real property," but held that it was a grant of an "estate in real property," within the meaning of the statute. The Oklahoma court carefully pointed out the distinction between the two terms. So the Court, in this case, as well as in the Continental Supply Co. case, has incorrectly stated the holding of the Oklahoma court, apparently due to the Court's idea that there is no difference between the two terms.

person in possession, by himself or tenant, of real property against any person who claims an estate or any interest therein adverse to him for the purpose of determining such adverse estate or interest, * * *." 51 C. J., p. 179.

(7) "the pledge of unaccrued royalty as security by the lessor of an oil and gas lease is a pledge of an interest in real estate;

(7) Here again, the Court is speaking of the lessor's interest; this statement throws no light on the nature of an oil and gas lease. Moreover, the pledge of unaccrued rents under an ordinary lease is also a pledge of "an interest in real estate." 32 Am. Jur., p. 364, Sec. 448; Ann., 31 A. L. R. 4.

(8) "and a mortgage upon land is a mortgage upon the oil and gas in place as an incident to the land itself.

(8) No basis for comparison. This statement has no relation to an oil and gas lease. It merely illustrates that while oil and gas are in place they are deemed a part of the land, a point which we have always conceded.

(9) "An assignment of an oil and gas lease requires all of the formalities of all other conveyances of real estate;

(9) The same. Title 16, Sec. 4, O. S. A., provides: "No deed, mortgage *or other conveyance relating to real estate or any interest therein,* other than for a lease for a period not to exceed one year, shall be valid until reduced to writing and subscribed by the grantors; ***"

(*10*) "it must be recorded as an instrument relating to real estate to impart notice;	(*10*) The same. Title 16, Sec. 15, O. S. A., provides: "* * * but no deed, mortgage, contract, bond, *lease or other instrument relating to real estate other than a lease for a period not exceeding one year* and accompanied by actual possession, shall be valid as against third persons unless acknowledged and recorded as herein provided." *Sargent* v. *Shaver,* 69 Okl. 282, 172 Pac. 445.
(*11*) "and a mortgage of an oil and gas lease must be recorded as a real estate mortgage."	(*11*) The same. See Title 16, Sec. 15, O. S. A., quoted above, and see the language of the Court in *Continental Supply Co.* v. *Marshall,* 152 F. (2d) 300, 307, which is equally applicable to an ordinary lease.

The above analysis conclusively demonstrates, we believe, that the same line of reasoning used by the Court of Appeals in this case leads to the conclusion that any lease of land, for however short a term, is subject to the tax.

Moreover, only by giving effect to the court's *incorrect statement* of the holding in *Nicholson Corporation* v. *Ferguson, supra* (see footnote, p. 30), are we able to perceive any logic whatever between the court's recital of the Oklahoma court's holdings and the court's conclusion that oil and gas leases are realty for documentary stamp tax purposes. Absent that erroneous statement, the court's concluding paragraph would read:

> "If an Oklahoma oil and gas lease is *an interest in realty* for all of the foregoing practical purposes,

we do not think that it is a perversion of its true character to say that it is *realty* for documentary stamp tax purposes."

That statement can be proper only if there is no difference between an interest in realty and realty, a matter which the Court of Appeals has previously decided in accordance with our contentions. *Sinclair Refining Co.* v. *Burroughs, supra.*

Although the court cites *Nicholson Corporation* v. *Ferguson, supra,* as holding that an oil and gas lease is "realty," actually that court said:

> "Failure to discern that the difference is great between 'real property' and 'an estate in real property' would be disastrous to our undertaking herein.
>
> • • • • • • • •
>
> "The degree, quantity, nature and extent of interest, which a person has in real property is usually referred to as an estate. It varies from absolute ownership down to naked possession."

And the court held that an oil and gas lease is "an *estate* in realty" within the meaning of Sec. 5980, C. O. S. 1921.

The Oklahoma court undoubtedly expressed the general rule in the foregoing statements. 1 Bouvier's Law Dictionary, page 1075.

Inasmuch as an estate or interest in land may be as little as "naked possession," we are at a complete loss to rationalize any conclusion that because a thing has been said to be an "interest in realty" it is "realty." And, as before mentioned, the court does not say that exactly, but throws in the erroneous statement that Oklahoma has held an oil and gas lease to be "*realty or* an interest therein," and upon that erroneous statement draws its conclusion.

Perhaps the Court of Appeals was confused by failure to distinguish between the different ways in which "interest in land" or "interest in realty" are used. If A owns a half interest in a tract of land, or if he owns the minerals, or a fraction thereof, but not the surface, he undoubtedly owns

land or realty. In that sense an interest in land is realty. *He owns a part of the things which constitute land.* But to say that one who has any right in land, such as a lease for years, a privilege to hunt and fish, an easement, etc., owns land or realty, is quite another thing. Such an interest in land is not realty. Realty is a freehold estate in land.

APPENDIX B.

An "Unless" Oil and Gas Lease Is Not "Lands, Tenements or Other Realty" Under General Federal Law.

In interpreting a statute under federal law, the courts are guided by the common law. *Welch, Commissioner,* v. *Kerckhoff,* (C. C. A. 9) 84 F. (2d) 295; *Smith* v. *Alabama,* 124 U. S. 465, 31 L. ed. 508, 512; *United States* v. *Wong Kim Ark.,* 169 U. S. 649, 42 L. ed. 890.

The words "lands, tenements or other realty" are substantially synonymous. 24 Words and Phrases (Perm. Ed.), p. 156, and 1948 Cumulative Supplement, p. 54; 24 Words and Phrases, p. 160; 41 Words and Phrases, p. 341; 1 Tiffany on Real Property (Perm. Ed.), Sec. 10; 42 Am. Jur., pp. 196-199.

In the courts below, respondent contended that the word "tenement" embraced a profit *á prendre* and therefore an oil and gas lease, citing *Kirschler* v. *Albanesius,* 13 N. J. Misc. 366, 178 Atl. 568, and *Marmet* v. *Archibald,* 37 W. Va. 778, 17 S. E. 299.

It is submitted that the true rule in this country is that a tenement does not embrace a lease for years as distinguished from a freehold. 42 Am. Jur., p. 198; *Jones* v. *Magruder,* 42 F. Supp. 193, 198 (D. C. D. Md.).

Moreover, any doubt that might otherwise exist as to the meaning of the word "tenement" is removed by the use of the word "other" in the phrase "lands, tenements or other realty." *United States* v. *Chase,* 135 U. S. 255; *United States* v. *Standard Brewery,* 251 U. S. 210, 64 L. ed. 229 (1919); *Jones* v. *Magruder, supra;* 50 Am. Jur., (Statutes) Sec. 241.

In addition, the Commisisoner, by G. C. M. 23295 (R. 34-35) has construed the statute as embracing only realty.

Realty Defined:

Realty is defined as a freehold estate in land. 1 Tiffany on Real Property (Perm. Ed.), Sec. 3; Restatement of the Law of Property, Secs. 8, 14-18.

An oil and gas lease is neither a "freehold" nor an "estate." It therefore cannot be realty.

1. An oil and gas lease is not an "estate."

It is an essential element of an "estate" that it be a possessory interest in land such as to exclude other members of society in general from any present occupation of the land. Restatement, Property, Secs. 7 and 9; 1 Tiffany on Real Property (Perm. Ed.), Sec. 23.

An oil and gas lease does not give to the lessee the exclusive right to possession of the land. The lessee has a right to *joint* occupancy with the landowner to the extent necessary to explore, drill for and produce the oil and gas (R. 33); 4 Summers on Oil and Gas, Sec. 652.

The lessee acquires no title to the oil and gas until reduced to possession. *Burnet* v. *Harmel,* 287 U. S. 103; *Ohio Oil Co.* v. *Indiana,* 177 U. S. 190; *United States* v. *Stanolind Crude Oil Purchasing Co.,* (C. C. A. 10) 113 F. (2d) 194, 198, and cases there cited.

The lessee's interest is in the nature of a profit *a' prendre,* an incorporeal hereditament. *Alexander* v. *King,* (C. C. A. 10) 46 Fed. 235, 238; *United States* v. *Stanolind Crude Oil Purchasing Co., supra.*

A profit *á prendre* is a *non*possessory interest. See comment on nonpossessory interest following Section 7 of Restatement, Property, and Illustration 4.

Thus it is clear that an "unless" oil and gas lease is not an "estate" and therefore lacks one of the essential qualities of realty.

2. If an "unless" oil and gas lease is an estate, it is an estate for years, not a freehold.

Even if an oil and gas lease be regarded as an estate, that is not enough to make it realty. In order to be realty it must be a freehold estate; an estate for years is not a freehold. The Commissioner concedes that a lease for five years is not taxable even if the right is granted to renew it for several successive terms. G. C. M. 23295, quoted in the petition, pp. 3-4. The Commissioner contends, however, that the provision in an oil and gas lease that it shall continue for a definite term and as long thereafter as oil or gas is produced makes it an estate of indefinite duration and therefore a freehold. It is our contention that the "thereafter" clause is no part of a *vested estate* in the lessee, but that the discovery of oil or gas during the primary term is a *condition precedent* to the extension of the lease beyond the fixed term, and therefore the lease is not of indeterminate duration. *Huggins* v. *Daley,* (C. C. A. 4) 99 Fed. 606; *Hutchinson* v. *McCue,* (C. C. A. 4) 101 F. (2d) 111, 118; *Western Pennsylvania Gas Company* v. *George,* 161 Pa. 47, 28 Atl. 1004; *Paraffin Oil Company* v. *Bruce,* 63 Okl. 95, 162 Pac. 716; *Roach* v. *Junction Oil and Gas Company,* 72 Okl. 213, 179 Pac. 934; *Moon* v. *Marker,* (Cal. Ct. App.) 78 P. (2d) 460, 462; *Solberg* v. *Sunburst Oil and Gas Co.,* 76 Mont. 254, 246 Pac. 168.

Moreover, it is generally held that an "unless" oil and gas lease conveys no vested interest in the land itself and is only an option to go upon the land and explore for oil and gas. *Gloyd* v. *Midwest Refining Co.,* (C. C. A. 10) 62 F. (2d) 483, and cases there cited.

Being only an option, it is a *condition precedent* to the extension of the lease beyond the first rental paying date (usually one year from date) that a well be commenced or the delay rentals be paid. Such a lease is in fact a lease from year to year. *Garfield Oil Company* v. *Champlin,* 78 Okl. 91, 189 Pac. 514; *Curtis* v. *Harris,* 76 Okl. 226, 184 Pac. 574.

A condition precedent is one which must take place before an estate can vest or be enlarged. 1 Tiffany on Real Property, (Perm. Ed.) Sections 185, 186; 19 Am. Jur., p. 521. *An estate on condition precedent is not an estate until* the condition is performed. I Tiffany on Real Property, (Perm. Ed.) Section 185.

It follows that an oil and gas lease which will continue for no more than one year without the commencement of a well or the payment of delay rentals as a *condition precedent,* or in any event will not continue beyond the primary term (usually ten years) without the discovery of oil or gas as a *condition precedent,* is not an estate of indeterminate duration but is an estate, if an estate at all, for years.

In line with these principles, which clearly demonstrate that an "unless" type of oil and gas lease is not realty, the majority of the courts have held that such oil and gas leases are chattels real and therefore personal property. *McElwaine* v. *Brown,* (Pa.) 11 Atl. 453; *State* v. *South Penn Oil Co.,* 42 W. Va. 80, 24 S. E. 688; *Connell* v. *Kanwa Oil Co.,* 161 Kan. 649, 170 P. (2d) 631, 634; *State* v. *Shamblin,* 185 Okl. 126, 90 P. (2d) 1053, 1055; *Heal* v. *Niagara Oil Co.,* 150 Ind. 427, 50 N. E. 482; *Kokomo Natural Gas and Oil Company* v. *Matlock,* 177 Ind. 220, 97 N. E. 787; *Jones* v. *Wood,* 6 Ohio C. D. 538, 9 Ohio Cir. Ct. 560; *Gulf Refining Company* v. *Glassell,* 186 La. 190, 171 So. 846; *Walla Walla Oil, Gas and Pipe Line Co.* v. *Valentine,* 103 Wash. 359, 174 Pac. 980; *Redmond* v. *Shaw,* 300 Mich. 314, 1 N. W. (2d) 555; *Thomas* v. *Standard Development Company,* 70 Mont. 156, 224 Pac. 870; *Benedum Trees Oil Company* v. *Davis,* (C. C. A. 6) 107 F. (2d) 981; *Morris* v. *Messner,* 156 Tenn. 54, 299 S. W. 782; *Miller* v. *Car,* 193 So. 45, 141 Fla. 318; *Boatman* v. *Andre,* 44 Wyo. 352, 12 P. (2d) 370, 374; *Shepherd* v. *McCalmont Oil Co.,* 38 Hun. 37.

It is thus clear that the concession by the Tenth Circuit Court of Appeals that an oil and gas lease is not realty under federal law was well warranted.

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IN THE SUPREME COURT OF THE UNITED STATES.

October Term 1949.

No. 529

PHILLIPS PETROLEUM COMPANY, A CORPORATION,
Petitioner,

vs.

H. C. JONES, COLLECTOR OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF.

1. Respondent has failed to discuss one of the most important issues.

Petitioner divided the question presented into four subsidiary questions (Pet., p. 5). The first and foremost was whether the Court of Appeals erred in holding that an oil and gas lease is realty within the meaning of the stamp tax statute, notwithstanding "It may be conceded that when judged by the laws of the States of Oklahoma and Kansas, OR THE GENERAL FEDERAL LAW, an oil and gas lease is not realty or an estate therein."*

The fourth subsidiary question was whether an oil and gas lease is realty under the general federal law. (The Court of Appeals conceded that it was *not*.)

*All emphasis in quotations supplied.

The first subsidiary question was covered by Point I of Petitioner's Brief (p. 11). It was there said that the decision of the Court of Appeals conflicted with *Case* v. *Los Angeles Lbr. Co.*, 308 U. S. 106, 84 L. ed. 110; *McNally* v. *Hill*, 293 U. S. 131, 136, 79 L. ed. 238, 241; *Keck* v. *United States*, 172 U. S. 434, 446; and other decisions of the Court of Appeals for the Tenth Circuit (pp. 13-15). In Appendix B (p. 34) petitioner discussed the fourth subsidiary question for the purpose of showing that, not only did the Court of Appeals concede that an oil and gas lease was not realty under general federal law, but that it was right in making the concession—probably immaterial to the petition for writ of certiorari, and for that reason relegated to the appendix.

Respondent discusses the second and third subsidiary questions (Br., pp. 5, 8), dividing the second into two parts (the issues presented by Points II and III of petitioner's brief, pp. 17, 22), but fails to mention the other questions.

The Court will see upon examining the issues ignored by respondent that they not only stand unrefuted by respondent, but that they are in truth irrefutable; the Court will see that the decision below is in fact directly in conflict with the decisions of this Court cited above.

One of the most important questions (if not *the* most important question) in this case is whether the courts are at liberty to ignore the meaning of the language used by Congress in tax statutes, and, without the aid of a single extrinsic fact or circumstance, declare that Congress meant something entirely different from what it said. This Court has said no to this question many times before, and respondent apparently is at a complete loss for an answer to petitioner's contention in this respect, so ignores it.

2. Respondent's argument would change the statute to read "lands, tenements or other realty, *or any interest therein.*"

With respect to the issues which respondent discussed, petitioner is content, subject to a few comments, to rest upon the presentation made in its petition and supporting brief. Petitioner does wish to point out, however, that respondent undertakes to support the decision below upon the ground that "although under state law the oil and gas leases in question might technically be labeled as 'personalty,' nevertheless they conveyed such substantial *rights* and *interests* in real estate as to require the imposition of the stamp tax under Section 3482." And further, respondent says that the Court below held that "state law, while affixing the label 'personalty' to oil and gas leases, nevertheless treats such leases as *interests* in realty for many practical purposes."

It will thus be observed that respondent, while rejecting the theory that state law governs, points to no other guide, but proceeds upon the unsupported premise that oil and gas leases are "in substance transfers of *an interest in* realty and *therefore* subject to the stamp tax * * *." Thus respondent would, by passing comment, arbitrarily change the controlling language employed by Congress, "lands, tenements or other realty" to read "lands, tenements or other realty *or any interest* therein." No reason is advanced to ascribe to Congress any such intent. If the test of the tax were merely whether an instrument transfers "an interest in realty," then all leases of realty, including a lease of farm lands for agricultural purposes or, indeed, a lease of residential property, even though for a short duration, would be subject to the tax, for beyond doubt such leases create "interests in realty." And it is universally held,

not only by state law but by federal law, that such leases are chattels real and are personal property, not realty. *Lycoming Fire Insurance Co.* v. *Haven,* 95 U. S. 210; 32 Am. Jur., p. 39; 19 Am. Jur., p. 519. The Bureau of Internal Revenue has always ruled that such leases are not subject to the stamp tax (R. 34). If there is to be a distinction between chattels real, some falling in the category of personal property and others as realty, where is the dividing line? What is the standard for determination? If oil and gas leases are chattels real, what is there about them that requires their classification as realty under the stamp tax statute and does not require the same classification of other chattels real, including ordinary farm or urban leases? No attempt was made by respondent to explain or justify this patent incongruity, for, to be sure, it is not susceptible of explanation.

Moreover, the court below did not hold that "interests in realty" are realty, but on the contrary conceded that oil and gas leases are not realty *under state or general federal law. What other guide is there?* Or is it to be frankly conceded that the court has broadened the statute to cover interests in realty if the particular "interest in realty" under consideration conveys such susbtantial rights, in the court's uncontrolled judgment, as to "require the imposition of the stamp tax"?

Petitioner cites *Morrow* v. *Scofield,* 116 F. (2d) 17, as holding that oil and gas leases are in substance transfers of an *interest in realty* and therefore subject to the stamp tax. That case was decided however at a time when Section 84 of Treasury Regulations 71 (1932 ed.) was in force. It provided: (*a*) "What constitutes 'lands, tenements, or other realty' is determinable by the law of the state in which the property is situated." The court applied the law of

Texas which was that oil and gas leases are realty. True, in an off-hand manner, and without the citation of a single authority, the court added: "The Texas decisions aside, * * * we think the comprehensive language of the federal statute makes it quite plain that it was the intention of Congress to require the affixing of stamps to instruments of this kind, instruments which in substance convey interests in lands, tenements or other realty without regard to the particular legal effect and consequences which may be attached to them by the laws of a particular state." Thus the court assumed that *interests* in "lands, tenements or other realty" are "lands, tenements or other realty" under federal law. Not only was that an erroneous assumption (see petitioner's brief, Appendix B, pp. 34-37), but *the Tenth Circuit in this case conceded the contrary.* That case therefore does not sustain the Court of Appeals' decision in this case.

The petition for writ of certiorari should be granted and the decision of the Court of Appeals should be reversed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 529

PHILLIPS PETROLEUM COMPANY, A CORPORATION, PETITIONER

v.

H. C. JONES, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 29-36) are not officially reported. The opinion of the Court of Appeals (R. 39-46) is reported at 176 F. 2d 737.

JURISDICTION

The judgment of the Court of Appeals was entered on August 2, 1949. (R. 46.) A petition for rehearing was denied October 12, 1949. (R. 49-50.) The petition for a writ of certiorari was filed on January 6, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the Court of Appeals correctly affirmed the holding of the District Court that the execution or assignment of oil and gas leases of indefinite duration, for a valuable consideration, constitutes a sale of "lands, tenements or other realty" within the meaning of Section 3482 of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 3480. IMPOSITION OF TAX.

There shall be levied, collected, and paid, for and in respect of the several bonds and other documents, instruments, matters, and things mentioned and described in sections 3481 and 3482, * * * the several taxes specified in such sections.

(26 U. S. C. 1946 ed., Sec. 3480.)

SEC. 3482 [as amended by Sec. 521 of the Revenue Act of 1941, c. 412, 55 Stat. 687]. CONVEYANCES.

Deed, instrument or writing, * * * whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his, her, or their direction, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $100 and does not

exceed $500, 55 cents; and each additional $500 or fraction thereof, 55 cents. This section shall not apply to any instrument or writing given to secure a debt.

(26 U. S. C. 1946 ed., Sec. 3482.)

Treasury Regulations 71 (1932 ed.):

Art. 84. *What constitutes real property determinable by law of State where located.*—(a) What constitutes "lands, tenements, or other realty" is determinable by the law of the State in which the property is situated. * * *

Treasury Regulations 71 (1941 ed.):

Sec. 113.81. *Definitions.*—As used hereinafter in this subpart—

(a) The term "deed" includes any instrument or writing whereby realty is assigned, transferred, conveyed to, or vested in, the purchaser or, at his direction, in any other person.

(b) The term "sold" imports transfer of title for a valuable consideration which may involve money or anything of value.

Sec. 113.84. *Conveyances Not Subject to Tax.*—In addition to the various exemptions * * *, the following are examples where the tax does not apply:

* * * * *

(i) Ordinary leases of real property for a definite term of years.

* * * * *

STATEMENT

The facts as found by the District Court (R. 29-35) are not in dispute. During the years 1942, 1943, 1944 and 1945, taxpayer purchased from landowners or acquired by assignment oil and gas leases in Oklahoma, which by their terms granted and leased exclusively unto taxpayer for a valuable consideration described land "for the purpose of investigating, exploring, prospecting, drilling and mining for and producing oil, gas and all other minerals, laying pipe lines, building tanks, power stations, telephone lines and other structures thereon to produce, save, take care of, treat, transport, and own said products, and housing its employees" for a stipulated primary term "and as long thereafter as oil, gas or other mineral is produced from said land". The leases further provided that they should terminate at the end of a year, unless operations for drilling were commenced or taxpayer paid a stipulated annual rental for the balance of the primary term. (R. 29-31.)

Taxpayer also acquired oil and gas leases in Kansas which were in all material respects the same as those purchased in Oklahoma, except that they did not cover minerals other than oil and gas. (R. 32.)

From October 26, 1920, until the stamp tax was repealed in 1926, and from 1932 until 1941, the Treasury Regulations provided that what constitutes "lands, tenements or other realty" is "determinable by the law of the State in which the

property is situated". Under the Regulations rulings were given at various times to the effect that Oklahoma and Kansas oil and gas leases were not subject to the stamp tax. However, Treasury Regulations issued in 1941 omitted any definition of the words "lands, tenements or other realty", and G. C. M. 23295, 1942-2 Cum. Bull. 271, issued in 1942, provided that "what constitutes 'lands, tenements or other realty' * * * is not controlled by the definition or scope of those terms under State law". This memorandum was given prospective force only. (R. 33-35.)

On July 14, 1945, the Commissioner assessed taxpayer with documentary stamp taxes in the amount of $9,581.55 on account of the execution and assignment of oil and gas leases. This assessment was paid September 21, 1945, and a claim for refund was filed March 1, 1946. This claim was rejected in full on June 26, 1946. (R. 32.)

On December 22, 1948, the District Court entered its judgment upholding the imposition of the documentary stamp tax (R. 36), and the court below affirmed (R. 46).

ARGUMENT

There are no conflicts and the decision of the court below is in accord with established principles of law.

1. The court below correctly held that although under state law the oil and gas leases in question might technically be labeled as "personalty", nevertheless they conveyed such substantial rights

and interests in real estate as to require the imposition of the stamp tax under Section 3482 of the Internal Revenue Code, *supra.* The Court of Appeals for the Fifth Circuit similarly decided, in *Morrow* v. *Scofield,* 116 F. 2d 17, that oil and gas leases, regardless of whether state law technically labels them as realty or personalty, are in substance transfers of an interest in realty and therefore subject to the stamp tax as conveyances of "lands, tenements or other realty" within the meaning of Section 3482. This Court denied certiorari. 313 U. S. 573.

The correctness of this approach is manifested by the fact, emphasized by the court below (R. 45-46), that in this instance state law, while affixing the label "personalty" to oil and gas leases, nevertheless treats such leases as interests in realty for many practical business purposes. See *Continental Supply Co.* v. *Marshall,* 152 F. 2d 300, 306 (C. A. 10). State law determines the nature of the interest actually created; the question then becomes whether the federal tax is applicable to such an interest, "irrespective of any particular characterization * * * in the local law." *Burnet* v. *Harmel,* 287 U. S. 103, 110; *Morgan* v. *Commissioner,* 309 U. S. 78, 80.

Moreover, since the same interest may, for technical reasons unrelated to economic realities, be labelled "personalty" in one state and "realty" in the next, it is obvious that unequal treatment of taxpayers in different states will result if the

sole test of the applicability of the federal taxing statute is the technical definition which the law of the state happens to favor. Thus, identical oil and gas leases would be subject to the federal stamp tax in Texas (cf. *Morrow* v. *Scofield, supra,* at p. 19), but not in Oklahoma (cf. *Continental Supply Co.* v. *Marshall, supra,* at pp. 305-307). Such a result would be inconsistent with the repeated holdings of this Court that taxing statutes will be applied in such a manner as to give uniform application to a nationwide scheme of taxation, unless the statute expressly or by necessary implication provides otherwise. *Burnet* v. *Harmel, supra,* at p. 110; *Morgan* v. *Commissioner, supra,* at p. 81.

2. There is no conflict with this Court's decision in *Helvering* v. *Reynolds Tobacco Co.,* 306 U. S. 110, which dealt with the *retroactive* amendment of Regulations in effect under a repeatedly reenacted section of tax statutes. Article 84 of Treasury Regulations 71 (1932 ed.), *supra,* providing that "what constitutes 'lands, tenements, or other realty' is determinable by the law of the State in which the property is situated", was *prospectively* amended by the exercise of the Commissioner's continuing rule-making power prior to the taxable years here in question (see Sections 113.81 and 113.84 of Treasury Regulations 71 (1941 ed.), *supra,* and G. C. M. 23295, 1942-2 Cum. Bull. 271 to eliminate this provision and, therefore, did not bind the court below to resort solely to state law, as contended by taxpayer, in resolving the ques-

tion of whether the oil and gas leases in question were "realty" within the meaning of Section 3482. This Court has long recognized that tax statutes and Regulations are not static and, consequently, that it is within the province of the Commissioner's continuing rule-making power prospectively to alter Regulations to conform with the dictates of experience, changing conditions and court decisions. *White* v. *Winchester Club,* 315 U. S. 32; *Helvering* v. *Wilshire Oil Co.,* 308 U. S. 90; *Morrissey* v. *Commissioner,* 296 U. S. 344. It is clear then that during the taxable years involved, the Regulations in effect prior to 1941 had no application and did not bind the court below. Moreover, even under the Regulations prior to amendment, courts were required to look to state law only for the character and nature of the instrument to be taxed under federal law (cf. *Morrow* v. *Scofield,* 116 F. 2d 17, 19), and this requirement has been met by the court below (R. 45-46).

3. Finally, there is no conflict, as asserted by taxpayer, with the decision of this Court in *Burnet* v. *Harmel,* 287 U. S. 103, where the income derived from the execution of an oil and gas lease by way of an initial bonus and royalties from the subsequent production of oil and gas was held to be ordinary income and not income from the sale of a capital asset. Taxpayer argues therefrom that the execution of an oil and gas lease cannot be considered a sale for purposes of imposing the stamp tax. But this Court, since its decision in

the *Harmel* case, has held that the assignment of an oil and gas lease for a valuable consideration is a sale (*Anderson* v. *Helvering,* 310 U. S. 404), and taxpayer necessarily has no argument with this proposition (Pet. 8). It contends, however, that a different rule must obtain upon the original execution of a lease. There is no merit or foundation to this putative distinction, for whether the lease be executed or assigned, the same bundle of rights and interests in realty is transferred and for a valuable consideration. Both constitute a sale of an interest in realty within the meaning of Section 3482.

CONCLUSION

There are no conflicts with the decisions of this Court or other Courts of Appeals, and the decision of the court below is in accord with established principles of law. No reviewable issue is presented and it is, therefore, respectfully submitted that the petition should be denied.

Respectfully submitted,

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